IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

CENTRAL TABLET MANUFACTURING CO., *Petitioner*,

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

1. There Is No Previous Case Or Logical Basis For Concluding That The Plan Of Liquidation Must Precede The Casualty In The Application Of Section 337 To Involuntary Conversions.

While conceding, grudgingly, that an involuntary conversion by casualty is to be treated as a "sale or exchange" under Section 337 (a), respondent urges adoption of the rule that the casualty is in all instances the point of the conversion. A rule which would cause a quite different application of the statute to involuntary conversions than to true sales and exchanges.

Respondent argues, in support of this rule, that this is the implication of *Towanda Textiles, Inc.* v. *United*

States, 180 F.Supp. 373 (Ct. of Cl. 1960) and *Kent Manufacturing Corporation v. Commissioner*, 288 F.2d 812 (4th Cir. 1961), as evidenced by the language in *Towanda* which refers to the involuntary conversion (caused in that case by a fire which occurred after adoption of a plan) as happening during liquidation and the language in *Kent* which distinguishes between the conversion and the realization of gain.[1] The language referred to, however, is equally consistent with the conclusion that involuntary conversion—as distinguished from the casualty—occurs at the point, following the casualty, that the right to receive insurance proceeds becomes unconditional or enforceable. In actuality, these cases do not bear on the narrow question raised here and the two cases that do—*United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968) and *Kinney* v. *United States*, 73-1 USTC, ¶9140 (D. C. Cal. 1972) are directly contrary to respondent's position.

While an involuntary conversion by casualty of insured property may not be literally a sale or exchange, it has the characteristics of both transactions. Like a sale, there is frequently a transfer of ownership, which is reflected by an adjustment for salvage, and like an exchange there is an exchange of one kind of property for another—insurance proceeds. Contrary to respondent's proposal, an involuntary conversion by casualty is not a single destructive event, but a transaction which occurs for the purpose of the application of Section 337 (a), when the right to receive insurance proceeds is no longer contingent.[2]

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1. As it does throughout, respondent assumes, circularly, that the involuntary conversion is the destruction (casualty) and that these cases, therefore, imply that the destruction must occur after adoption of the plan.
2. This characterization of an involuntary conversion was referred to in *Helvering v. Flaccus Leather Co.*, 313 U.S. 247, 249 (1941) as follows: "The fact that §112 (f) characterizes destruction of property and indemnification for its loss as in involuntary conversion does not establish that the two events constituted a sale or exchange".

2. The Analogy Between The Destruction Of Petitioner's Property By Fire And The Taking Under An Eminent Domain Proceeding Is False.

From the outset of this case, respondent has avoided comparison of the fire loss with a sale and has sought instead to relate it to a taking under eminent domain statutes. There is a significant difference, however, between the taking in eminent domain and the fire in this case.

In a condemnation, the taking marks the entry of the condemnor into possession and gives rise to an enforceable obligation to pay just compensation. *Best* v. *Humboldt Placer Mining Co.*, 371 U.S. 334, 340 (1963); *United States* v. *Dow*, 357 U.S. 17, 22 (1958). Indeed, it is only because of the creation of this enforceable obligation that the taking is constitutional. See *Yearsley* v. *W. A. Ross Construction Co.*, 309 U.S. 18 (1940). The casualty in an involuntary conversion on the otherhand gives rise, at most, to a conditional or contingent claim. The insurer is under no obligation unless and until a number of actions are taken by the insured—notice of loss, proof of loss in accordance with the terms of the policy and other requirements for recovery under the policy.

The contingent nature of an insurance claim can be no more clearly shown then by the facts of this case. Thus, the insurers rejected petitioner's proofs of loss (R. 13-15, 48); took the position that their liability under the building loss policy was limited by the operation of a co-insurance clause (R. 23, 33); and disagreed with petitioner as to the machinery and equipment that was repairable and, in some cases, as to its coverage under the policy (R. 27, 28). All of these contingencies to the receipt of insurance proceeds remained until acceptance by insurers of petitioner's proofs of loss, which postdated adoption of its plan of liquidation. And it was this event,

not the fire, which transmuted petitioner's property rights in the damaged property into an enforceable right to insurance proceeds—the involuntary conversion.

The further argument that to permit nonrecognition treatment where the casualty precedes the adoption of a plan of liquidation is to favor taxpayers in petitioner's position by allowing them to decide whether to rebuild or to liquidate[3] is not persuasive. Under existing Treasury Regulations[4], sales may be negotiated before a plan of liquidation is adopted and still be entitled to nonrecognition and, under probably the greater number of statutes, the landowner knows well before the taking that eminent domain proceedings will be brought. In truth, in this regard, a reversal of the judgment of the court of appeals in this case will have the effect of placing petitioners and similarly situated taxpayers on an equal footing with taxpayers involved in true sales and exchanges.

Nor is there merit to the ominous prediction that any rule other than that an involuntary conversion occurs at the time of the casualty will reintroduce the uncertainty to the corporate liquidation process that §337 was designed to eliminate. Certainly, the provision in Treasury Regulation, §1.337-2 (a) that "[t]he date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances" gives rise to this same kind of factual determination. And just as

3. This fear appears largely to have been the basis for the judgment of the court of appeals below (Petition For Writ Of Certiorari, p. 30).

4. §1.337-2 (a) provides "***[i]n ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded".

certainly, this kind of determination must be made time and again in the administration of tax laws and laws generally.

The fact that the time of the occurrence of a casualty is easily ascertainable is no basis in law for arbitrarily fixing it as the time of the involuntary conversion.

3. The Time Of The Involuntary Conversion Is Not Extended Beyond The Holding Period And Ownership Of The Converted Property Under Petitioner's Theory.

Respondent's argument here is that this Court in *McFeely v. Commissioner*, 296 U.S. 102 (1935), held that taxpayer's holding period with respect to property is coterminous with the period of his ownership and that it has been subsequently held—*Rose* v. *United States*, 229 F. Supp. 298 (S. D. Cal. 1964); *Steele* v. *United States*, 52-2 USTC ¶9451 (S. D. Fla. 1951)—that a taxpayer's ownership ends at the time of the casualty in an involuntary conversion.

Accepting the principle stated in *McFeely* v. *Commissioner*, it still does not follow from *Rose* and *Steele* that petitioner's ownership of its fire damaged property ended with the fire.

In *Steele*, the vessel—the insurance proceeds from which were claimed by taxpayer to reflect long term gain—sank without a trace[5] and presumably ownership and possession were abandoned. In *Rose*, the casualty was also the sinking of a vessel and, although the location of the hulk was known, no effort was made by either the taxpayer or the insurer to investigate the loss or to attempt salvage operations. While an arbitrary termination date for ownership corresponding to the date of

5. The decision gives no further facts or supportive reasoning.

casualty was fixed by both courts, the date seems justified under the peculiar facts of those cases. But clearly, those determinations are not dispositive of the question of ownership under the differing circumstances of this case.

In *Central Tablet*, both the building and the personal property remained in existence—although damaged and rendered largely useless by the fire—and petitioner's ownership continued until the damaged property was, in effect, exchanged for insurance proceeds. A transaction which took place no sooner than the acceptance of proofs of loss by insurers.

To say, as respondent must to sustain its position, that in every involuntary conversion by casualty case, title to and ownership of the property terminates at the time of the casualty is to ignore the facts of this case and the circumstances of most casualty losses. Contrary to respondent's argument, petitioner's position in this case and the decisions in *United States* v. *Morton, supra*, and *Kinney* v. *United States, supra*, are consistent in principle with this Court's decision in *McFeely* v. *Commissioner*, and can be squared on the facts with the holdings in *Steele* and *Rose*.

In summary, an involuntary conversion by casualty, like a true sale or exchange, is a transaction which occurs for the purpose of the application of Section 337 (a) at the point that an enforceable obligation to receive money or tangible property arises. Under the facts of this case, this definitive event occurred at the time of the acceptance of proofs of loss by the insurers, following the adoption by petitioner of its plan of liquidation. It follows that petitioner is entitled to the application of the remedial nonrecognition provisions of Section 337

(a) and that the judgment of the court of appeals denying such application is in error.

Respectfully submitted,

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